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Testimony before the Subcommittee on Highways, Transit and Pipelines of the
House Transportation and Infrastructure Committee

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Mr. Chairman and Members of the Subcommittee:

My name is Mark Florian and I am the COO of the Municipal Finance and Infrastructure Group for Goldman, Sachs & Co. and I also manage our North American Infrastructure Investment Banking business. I appreciate the opportunity to testify before the Subcommittee today on "Understanding Contemporary Public Private Highway Transactions: The Future of Infrastructure Finance".

I. EXECUTIVE SUMMARY

Municipal budgets continue to be constrained as the infrastructure demands of municipal governments grow dramatically. As a result, state and local governments have begun to access non-traditional forms of financing for capital and operating needs. One strategy that is used globally, but is relatively new in the United States, is the public-private partnership (PPP). Under PPP agreements, state and local governments receive compensation (either in the form of a substantial up-front payment or as an ongoing annuity) to contract with a private operator who provides operating, maintenance and/or construction expertise for large-scale infrastructure projects.

Fueled by the investment of pension funds and insurance companies searching for steady, predictable cash flows, the PPP market is a particularly effective financing tool for toll roads, which are able to monetize future volume and toll increases while offloading future operating and capital expenditure risk. Specifically, in many European, Asian and Australian markets, PPP has become the primary source of infrastructure funding for government transportation agencies. The structure and accordingly the benefits that may be derived from a PPP concession may take various forms from one time up-front payments to on-going revenue sharing structures, while initial construction and/or expansion programs can be combined with either of the two. With the recent success of two major U.S. PPP transactions in Chicago and Indiana, an investor class with a strong interest in infrastructure assets and a growing acceptance of the PPP concept in states and local governments, we believe that public-private partnerships are a key part of the new frontier of infrastructure finance.

II. MARKET OVERVIEW

The United States is at a crossroads in its transportation infrastructure lifecycle. Large capital investments have been identified across the nation, which are critical to sustaining the U.S.'s economic growth and quality of life. Traditional funding sources have not kept pace with these needs, thereby requiring local governments to search for alternative and innovative financing approaches to deliver these projects. Given the magnitude of the major capital needs on the horizon, states and local governments have begun to consider alternative forms of financing, including the significant financial resources that can be provided by the global infrastructure PPP market.

While it has been customary for the local municipalities to finance the improvement and maintenance of their infrastructure, they are capacity constrained and limited in the ways they can finance their assets. Many of these states, cities and authorities have millions, if not billions, of dollars of debt associated with each of their assets. In addition, the tax-exempt market, where these assets are traditionally financed, imposes strict limitations on the amounts of leverage that can be layered onto each asset as well as restrictive coverage requirements and additional bonds tests.

There are a number of ways through the traditional tax-exempt markets that municipalities fund transportation projects. Highway projects are most typically (and conservatively) financed through a securitization of motor

fuel taxes. This revenue stream is not nearly enough to cover the outstanding maintenance and capital improvement costs associated with many of these assets. These funds can be supplemented through the various transportation funding programs implemented by the federal government. Specifically, many states leverage their receipts under SAFETEA-LU through Grant Anticipation Revenue Vehicles (GARVEE bonds). GARVEE financings can offer states and local governments additional sources of funds for their infrastructure projects but can be subject to conservative assumptions and a haircut of value due to the inherent risk of reimbursement. Additionally, many capital constrained projects can apply for a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan, which is specifically designed to aid progressive transportation projects. A TIFIA loan can provide low cost funds that offer immense flexibility for new and complex projects, but can also be quite restrictive.

Ultimately, these financing mechanisms, though extremely effective on a project-by-project basis, do not provide enough proceeds to renew and expand our nation's infrastructure. More and more, municipalities are turning to the private sector to finance and own their infrastructure projects. Public private partnerships can provide municipalities with the capital injection that is necessary for the continuation of a healthy transportation system. In addition, PPPs offer the municipalities a way to monetize certain assets and provide funds to accelerate desperately needed projects.

III. PUBLIC-PRIVATE PARTNERSHIP OVERVIEW

Public-Private Partnership Trends in the US

Many municipal governments are considering public-private partnerships to achieve funding goals in the wake of large capital needs and restrictive budgets. For example, the State of Indiana recently found itself faced with a \$2.8 billion deficit in its 10-year transportation plan. After determining that the maximum potential tax-exempt proceeds would be insufficient to fund its plan, the State retained Goldman Sachs to execute a PPP concession process, which concluded with the acceptance of a \$3.85 billion bid in exchange for a 75-year lease of the Indiana Toll Road. The proceeds from the lease will be used to fully fund the transportation plan, accelerate several other projects that will upgrade and enhance Indiana's infrastructure, generate significant new construction and manufacturing jobs, and lower the State's future debt issuance and interest costs. In addition to this up-front payment, the private operator expects to spend \$4.4 billion (2006 dollars) to maintain and expand the Indiana Toll Road over the life of the lease.

Similarly, Goldman Sachs also advised the City of Chicago on the \$1.83 billion concession lease of the Chicago Skyway, which was announced in 2005. In Chicago, the City used the proceeds to pay down existing debt, establish a \$500 mm "Rainy Day" fund, allocate \$375 mm to the annual operating budget, and fund several social service programs. In addition, the City received an upgrade from S&P from A to A+.

In light of these transactions, many governments are recognizing that the steady annual cash flow that toll transactions produce are of immense value to private operators. One of the key drivers of value in both the Indiana Toll Road and Skyway leases was the ability of the buyer to pay for the future cash flows that the road would produce. The debt markets, which have historically supported public toll roads, rely primarily on historical growth to determine the borrowing levels for a toll road. Equity investors in PPP projects, however, are willing to pay for the expected value of future cash flows from steady revenue-producing assets such as a toll road, and they are often comfortable taking a more optimistic view on the future performance of established assets.

Currently, several other states have begun to contemplate and employ similar models to gain alternative funding for infrastructure expansion. Specifically, the State of Texas is currently assessing the financing alternatives for seven new toll roads, including a private concession model. However, Texas is also evaluating the applicability of Private Activity Bonds and TIFIA loans for its projects. It may be the case that the State of Texas is able to utilize these federal funding techniques in combination with a PPP. The State of Utah is also engaged in determining the appropriate funding technique for a new toll road project. In conjunction with this process, the State of Utah recently passed PPP legislation to enable PPP as a viable financing alternative, which it is seriously pursuing for the project. Also, Harris County Toll Road Authority, owner and operator of the vast toll road network around Houston, has procured a team to study the various alternatives in the PPP market.

Benefits of Public Private Partnerships for States and Local Governments

The benefits of Public Private Partnerships include:

- ***Flexibility with Use of Proceeds:*** The municipality could utilize the up-front proceeds to accelerate needed transportation or other projects. The true value of the ability to utilize the proceeds of a PPP for any use determined by the municipality is enhanced by the strict limitations of tax regulations for the use of any proceeds from a tax exempt bond deal. Through a PPP, the municipality is able to utilize the proceeds for a variety of uses that could range from accelerating planned transportation projects to funding social service programs. The City of Chicago retained a portion of the proceeds from the lease of the Skyway for a “rainy-day” fund that ultimately aided in the ratings upgrade of the City – and that will lower future financing costs.
- ***Greater Up-front Proceeds:*** A public private partnership allows the municipality to capture greater upfront value than a municipal bond transaction, given that the municipality is paid based upon the growth of future cash flows of its infrastructure assets, as compared to focusing on historical cash flow in the debt market.
- ***Strict Operating Standards:*** The municipality can carefully craft the terms of the concession agreement to achieve strict operating standards that meet the municipality’s public policy goals. If the concessionaire does not comply with the standards, ultimately the municipality can take the road back by canceling the concession. Both the Indiana Toll Road and the Skyway transactions have 300-page operating standards that address, in great detail, the manner in which the roads will be operated and maintained.

Considerations of Public Private Partnerships

The principal points of consideration in determining whether to pursue a public private partnership vs. other strategies are as follows:

- 1) ***What are the public policy implications of retaining ownership but transferring operations to another entity for a predefined period of time in accordance with a concession agreement?*** Clearly, the public policy concerns associated with a private entity leasing or owning a public asset are a major factor in a PPP and must be contemplated very carefully. Again, recent experience demonstrates that PPP financing can work to satisfy both public policy needs and the interests of investors. It is also important to consider the future of the municipal employees as a result of a concession. It is possible for concession contracts to be written so a concessionaire must use municipal employees for all or a portion of toll collection, maintenance, administration, etc.
- 2) ***What control issues is the municipality relinquishing under this model?*** Since the municipality remains the owner, this inherently enables them to retain a greater degree of oversight of the ongoing maintenance and operations. In addition, the municipality determines a detailed list of operating standards that the concessionaire is required to follow. The municipality has the right to terminate the lease upon failure to meet any of these standards, which also allows the municipality further control under a PPP.
- 3) ***The length of the potential concession agreement will be important in determining potential proceeds.*** The term of the concession must be sufficient to provide the concessionaire the benefit from depreciation. This creates flexibility to depreciate the asset in the most attractive manner. The length of the concession agreement is also an important public policy decision. The State of Indiana ultimately decided to scale back to a 75-year lease from a 99-year lease after preliminary indications showed that value would not be severely affected.

Process Overview

The public-private partnership process is complex but is most likely able to be completed within 9–12 months. For example, the Indiana Toll Road process is anticipated to close in June, which is 9 months from the launch of the RFP process and 5 months from the receipt of bids. The key items to implement in a PPP are:

- Legislative approval
- Prepare feasibility study/projections
- Obtain any Federal Highway Administration or other federal approvals
- Draft concession agreement and operating standards

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- Solicit bidders and select top quality firms/consortia
 - Due diligence/negotiation of key agreements

The implementation of a successful public private partnership is dependent on many factors. A strong foundation of preliminary groundwork may contribute heavily to the later success of a municipality's PPP efforts. An overview of a typical PPP process is outlined below:

- 1) Organizational Phase
- 2) Internal Due Diligence Phase
- 3) Pre-Marketing Phase
- 4) Marketing Phase
- 5) Close Transaction Phase

IV. WHY THE SUDDEN EMERGENCE OF THE PPP MARKET?

Seemingly overnight, large amounts of money are being pooled into a variety of funds to solely invest in infrastructure. Goldman Sachs is raising an infrastructure fund more than of \$3 billion, the Carlyle Group is targeting a \$1 billion fund and numerous other firms are contemplating funds of similar magnitudes. These funds are driven by the significant demand for the infrastructure asset class from a long list of toll road companies, pension funds, insurance companies, construction/engineering firms, private equity funds, as well as potential public entities. These investors seek steady long-term returns from infrastructure assets. Additionally, the infrastructure asset class provides these investors with an additional method of diversification for their investment portfolios.

The inherent value that can be realized by a private investor above and beyond what can be realized by the municipality in the tax-exempt market is the main value driver of the PPP market. Private investors are able to realize more value from these assets than a municipality. In addition, the private investor most often bids in conjunction with an experienced operator that will manage the operations of the asset upon sale. Ultimately, a private operator is more likely to be able to hold down expenses and manage the asset more efficiently simply due to economies of scale and experience.

V. CONCLUSION – ARE PPPs THE FUTURE OF INFRASTRUCTURE FINANCE?

The need for alternative funding to repair and replenish the nation's infrastructure has given rise to the increased prevalence of public private partnerships in the United States today. There are pools of private capital that are available for this very purpose. Public private partnerships are truly mutually beneficial – municipalities are able to monetize assets for up-front cash payments to fund future projects or inject additional capital in others while private owners, operators and investors are able to access the steady stream of cash flows produced by infrastructure assets. The marriage of private operating efficiencies and incentives with essential public assets can only enhance our nation's transportation infrastructure.

As budgets become increasingly constrained and funding sources harder and harder to come by, it is likely that PPPs will become a prominent fixture in the infrastructure finance landscape. The growth in the PPP market in the past year has been exceptionally strong and there is every reason to believe that it will continue in the future. Public private partnerships are a very real and practical solution to many of our local municipalities' transportation funding crises. Although a PPP may not be appropriate for every project or municipality, it provides a valuable alternative to the current financing options that are available.

APPENDIX. CASE STUDIES



\$3.85 BILLION CONCESSION LEASE OF THE INDIANA TOLL ROAD

Goldman Sachs recently served as the public private partnership advisor to the State of Indiana on the \$3.85 billion 75-year concession lease of the 157 mile Indiana Toll Road (the "Toll Road"). The transaction is currently scheduled to close in June 2006.

The Indiana Toll Road PPP process began in July 2005 after the State determined it needed to consider alternative sources of capital to fund the \$2.8 billion deficit in its 10-year comprehensive transportation plan. The plan, entitled "Major Moves" represented the Governor's vision to create jobs and drive economic growth by transforming Indiana into a transportation logistics hub via the construction of several key road projects.

The State spent several months analyzing the pros and cons of pursuing a public private partnership, including a review of the standalone bonding capacity of the Toll Road, a strategic analysis of the potential valuations that a bidder would be willing to pay, and an assessment of the level of interest of the bidding community. In the end, the State decided to proceed with an accelerated concession process in which binding offers would be received within 120 days. The primary reason for the tight time frame was a need to deliver bids to the legislature for approval prior to adjourning in early March.

Given the accelerated pace, Goldman Sachs moved quickly to utilize its global network to contact over 70 potential buyers around the world. Leveraging the relationships and expertise that we have gained as the advisor to the City of Chicago in the Skyway concession sale and to several international toll road projects (including the recent sale of the remaining public interest in the French Toll Road system), we were able to dramatically increase the overall level of interest in the Toll Road beyond what was witnessed in the Skyway process.

During the process, Goldman Sachs provided the State with risk pricing for the important policy decisions they needed to make in the Concession Agreement. For example, they were able to make the decision to shorten the concession from 99 years to 75.

In January 2006, we received binding offers from four of the final bidders. The winning bid, \$3.85 billion, was submitted by Cintra-Macquarie, the same team that won the auction to own and operate the Chicago Skyway. The State legislature authorized the transaction in March 2006, and financial close is expected to occur in June 2006.



\$1.83 BILLION CONCESSION LEASE OF THE CHICAGO SKYWAY

Goldman Sachs advised the City of Chicago on the privatization of the Chicago Skyway that generated a winning bid of \$1.83 billion. The City solicited Requests For Qualifications in the spring of 2004 resulting in ten international consortia submitting preliminary proposals to purchase the concession. Five consortia were deemed qualified by the City and were invited into an intensive due diligence process. The 99-year concession transaction closed on January 24, 2005 and the \$1.83 billion was delivered to the City on that day. Annual engineering inspections and monitoring of operations will be conducted over the life of the agreement per the 300 page operating standards manual. In addition, the concessionaire is mandated to complete several specific capital improvements to the Skyway.

The Chicago Skyway is the first toll road privatization of an existing road in the United States. The Chicago Skyway is a 7.8 mile divided elevated toll road and toll bridge and has 3 lanes in each direction. It connects to the Indiana East-West Toll Road to the Dan Ryan Expressway. Recent traffic flows have been affected by major restrictions due to the capital works program which began in 2002. Tolls, which had not changed since 1993, were \$2 per car, \$1.20 per truck axle. Prior to the concession, all of the tolls had been collected manually and the concessionaire is encouraged to enable electronic tolling.

The Skyway's key strengths include a lack of competing direct routes, minimal impact of toll increases on traffic demand, strong cash flow margins and revenue growth rate; limited future capital expenditures;

modernization potential, and a beneficial economic environment.

Summary Financial/Operating Information				
(\$000)	2000	2001	2002(a)	2003(a)
Revenues (\$) ^(b)	39,214	44,004	43,232	39,770
Operating Expenses (\$) ^(b)	7,896	9,106	10,050	11,417
Cash Flow (\$)	31,318	34,898	33,182	28,352
Total Vehicles (000)	16,516	18,717	18,711	17,422
<small>(a) Lane closures due to CIP impacted traffic and revenues; completion of CIP is expected by December 2004. (b) Source: Audited financial statements.</small>				

Goldman Sachs led a 2-year process to privatize the Chicago Skyway. The bidding process was designed to create maximum bidder tension to potentially enhance value in a tight competition for this asset. In the end, the Cintra-Macquarie Consortium submitted the winning bid.

Cintra-Macquarie is widely respected as a premier international toll road operator with 35 years of demonstrated experience. It operates more than 30 toll road concessions spanning over 1,000 miles including the Highway 407 toll road in Toronto (99-year concession for a 60-mile toll road) and is involved in the last three private U.S. toll road financings. Furthermore, it has raised over \$10 billion in both debt and equity for the financing of toll roads.

The City explored this concession sale for several reasons. The City believes that a private operator will provide high customer service and traffic flow. It was a favorable time for a sale because the City had invested \$300 million in improvements, tolls have not been increased since 1993, and there is continued economic development in region. The sale also gave the City the opportunity to maximize City tax-payer benefit with monetization of toll increases. Finally, net proceeds were used to defease/cancel \$400 million in existing Skyway net debt; and to establish a reserve fund to finance City public-service initiatives.



UDOT - MOUNTAIN VIEW CORRIDOR

Goldman Sachs is currently serving as the State of Utah Financial Advisor for the Mountain View Corridor (MVC), a 40-mile new highway project connecting I-80 west of the Sale Lake City Airport and running south along the western portion of the Sale Lake Valley into Utah County. UDOT is well under way on its EIS process, having spent the last 18 months developing alternative configurations for the \$1.5 to \$2.5 billion project. The EIS is expected to be completed in mid-2007, with a Record of Decision expected by late 2007.

UDOT management and staff have been focused on studying all possible alternatives for the new road, knowing that the State's available financial resources for transportation projects are very limited. The average annual funding for all transportation in the State is less than ten percent of the cost of the new project. Tolls are being studied as an alternative that may provide the necessary funding. As to the capitalization of such potential tolls, the newer concession approach is being modeled with the inherent Greenfield projects risks in mind and is being compared and contrasted to the traditional tax-exempt tolling authority model.

While UDOT has significant experience with design-build processes, having procured one of the largest design-build contracts in US history for the \$1.6 billion I-15 project, UDOT has not previously utilized the concession model and a public-private partnership to procure new road projects.

Earlier this year, and together with UDOT staff, Goldman Sachs prepared and presented multiple briefings to both the Utah Transportation Commission and for the leadership of the Utah State Legislature regarding the options of public-private partnerships in general and procurement via concession specifically.

Over a three month legislative session, Goldman Sachs' personnel testified at various legislative hearings and briefed all levels of the State's executive branch on the Chicago Skyway process and success as well as the then-pending Indiana Toll Road process. GS also suggested numerous specific points for the proposed legislation. The Legislature responded by passing PPP legislation giving UDOT a PPP option it has not had previously.

Greenfield projects carry a completely different level of risk above that of the Brownfield projects. Goldman

Sachs surveyed various members of the international bidding community, rating agencies, monoline insurers and toll road operators on the specific process variations that could create similar success in Greenfield procurements using the concession model. Goldman Sachs understands how Greenfield project risks may impact the size of the field of possible bidders and the ultimate levels of valuation in the concession of a Greenfield project. Changing as many unknowns to knowns is key to this process. We have brought our experience on Brownfield projects and our knowledge of specific characteristics of Greenfield projects to UDOT's process, helping the team to evaluate the alternatives with a greater level of confidence in this cutting-edge alternative procurement possibility.

For the past two months, we have been modeling the MVC in all of its configurations, taking inputs from all other consulting team members. Traffic studies, preliminary engineering, and funding possibilities combine in these models to test the leveraging capabilities of the various debt and equity mixes.

We will continue to serve as UDOT's financial advisor, helping the State through the toll/no toll decision, and through the choice of a preferred procurement. Results from our modeling and testing process will help UDOT staff and the State's policy makers make proper determinations and decisions in order to deliver the MVC at the lowest possible cost to the State and to the ultimate users of the MVC. Goldman Sachs is committed to helping the State of Utah and UDOT find maximum financial leverage in order to minimize the annual funding required to deliver this exciting new Corridor for the fastest growing sectors of Salt Lake and Utah Counties.



TEXAS DEPARTMENT OF TRANSPORTATION

Goldman Sachs was hired in October 2005 by the Texas Department of Transportation to serve as concession advisor on their Comprehensive Development Agreement (CDA) program. Goldman Sachs works closely with TxDOT staff and outside advisors (including Nossaman, Guthner, Knox & Elliott LLP) to analyze and deliver the most efficient financing solution from the following options:

- Pay-as-You-Go
- Highway Revenue Bonds
- Toll Revenue Bonds
- Concession
- Asset Sale

This analysis has resulted in a more refined process for determining project eligibility for typical pay-as-you-go or tax-exempt bond road financing, or utilizing a concession approach. Furthermore, we are helping TxDOT develop a programmatic approach to technical provisions, determining the role of other organizations in CDAs, developing a master schedule, managing resources and balancing stakeholder requirements. Provided below are several current road procurements we are advising:

- SH 121 – This segment runs through both Collin and Denton counties. There are four proponent bidders short-listed.
- IH 635 – Four proponent bidders are short-listed for this procurement. This project creates a partial loop around the City of Dallas.
- Loop 1604 – This project will provide a critical road capacity for the San Antonio area. Two proponent bidders have been short-listed.
- IH 820 – This Dallas project is undergoing programmatic re-evaluation for inclusion in the CDA process.
- SH 130 Segments 5&6 – We are evaluating the merits of a negotiated concession approach on these segments including assumption and financial analysis verification.
- TTC 69 and SH 161 – These high priority projects are undergoing programmatic evaluation for inclusion in the CDA Program.

Our engagement with TxDOT is projected to last multiple years as these projects are in varying stages of development and there is potential for even further CDA projects beyond those mentioned above.